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In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 897

FRANCIS G. COATES, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A, 3587–3692) is reported at 401 F. 2d 833. The opinion of the district court (Pet. App. B, 1–63) is reported at 258 F. Supp. 262.

JURISDICTION

The judgment of the court of appeals was entered on August 13, 1968. Petitioner filed a petition for rehearing on September 20, 1968, which was denied on October 7, 1968. The petition for a writ of certiorari

was filed on January 3, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder prohibit a director who knows corporate news which is of great importance to persons trading in the corporation's securities, and which is announced at a special press conference called by the corporation, from purchasing shares from stockholders of the corporation immediately after that announcement but prior to publication of the announcement in any news medium of widespread circulation.

STATUTE AND RULE INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b–5 of the Commission, 17 CFR 240.10b–5, are set out at pages 3–4 of the petition.

STATEMENT

The court of appeals, sitting *en banc,* unanimously held that petitioner had violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder when he telephoned his stockbroker to purchase stock of Texas Gulf Sulphur Company (hereafter "Texas Gulf"), of which petitioner was a director, on the basis of highly important corporate information contained in a press release just handed to representatives of the news media at a special press conference, which information petitioner "could not reasonably have expected * * * to have been dissemi-

nated when he placed his order * * *" (Pet. App. A, 3622).

This action arises out of Texas Gulf's discovery of a large deposit of base and rare metals on land located near Timmins, Ontario, Canada. Following aerial and ground geophysical surveys, drilling was commenced on November 8, 1963, and was suspended four days later (Pet. App. A, 3596). From November 13, 1963, to March 30, 1964, drilling remained suspended while Texas Gulf purchased most of the outstanding interests in the land (Pet. App. A, 3596–3597; Pet. App. B, 8–9). Drilling was resumed on March 31, 1964 (Pet. App. A, 3597). On April 16, 1964, Texas Gulf held a special press conference to issue a release announcing that it had "made a major strike of zinc, copper and silver * * *" (Pet. App. B, 40–41). Neither the accuracy of this release nor the importance of this discovery to Texas Gulf is questioned.

1. THE COMMISSION'S COMPLAINT

On April 19, 1965, the Commission filed a complaint (R. 2851–2885) in the district court alleging that, during the period after the initial suspension of drilling and before the information contained in the April 16 press release became available to the public, thirteen officers, directors and employees of Texas Gulf, including petitioner, had each committed one or more of the following violations of Section 10(b) and Rule 10b–5:

> 1. Purchased Texas Gulf common stock or calls on that stock on the basis of the results of the drilling without appropriate disclosure.

2. Divulged that information to friends, relatives or business associates for use in their purchases of Texas Gulf stock or calls, without appropriate disclosure, or recommended on the basis of such inside information that they purchase Texas Gulf securities.

3. Accepted stock options from Texas Gulf with knowledge of this information, which had been withheld from the directors of Texas Gulf. ~~without appropriate disclosure.~~

It also alleged that Texas Gulf had violated Section 10(b) and Rule 10b–5 by the issuance of a false and misleading press release about the metal deposit on April 12, 1964.

The complaint requested that the defendants be permanently enjoined from future similar violations of Section 10(b) and Rule 10b–5; that the individual defendants who had violated those provisions by purchasing Texas Gulf stock or calls be required to offer rescission to the sellers; that those who had divulged such information be required to offer restitution to stockholders who had sold Texas Gulf securities to the recipients of the information; and that stock options accepted unlawfully be rescinded (R. 2883–2885).

2. THE EVIDENCE AS TO PETITIONER

The trial was limited to the issue whether the defendants had violated Section 10(b) and Rule 10b–5, and the question of remedies was left for a further hearing (Pet. App. B, 1).

Petitioner, a senior partner in a large law firm in Houston, Texas, that represents Texas Gulf, had been

a director of the corporation for some 15 years (R. 132–133). He is also the trustee of four trusts for his children (R. 153). Prior to April 13, 1964, he had no knowledge of the results of Texas Gulf's drilling near Timmins (R. 144).

By April 11, 1964, rumors that Texas Gulf had made an ore discovery, which had previously circulated in Canada, appeared in the New York press (R. 99). Texas Gulf then decided to issue a press release on the subject (R. 1132–1138). The release was issued on April 12 and appeared in the morning newspapers on the following day (Pet. App. B, 49). The release labeled the rumors as "exaggerate[d]," "without factual basis" and "unreliable"; it further stated that "[t]he drilling done to date has not been conclusive * * *" (Pet. App. B, 50–51). It promised that, when sufficient drilling was completed, "TGS will issue a definite statement to its stockholders and to the public * * *" (Pet. App. B, 51). Prior to April 15, petitioner's knowledge of the exploration results was limited to press reports of this release (R. 144–145).

On the afternoon of April 15, the top management of Texas Gulf decided to hold a press conference the next morning, following a regularly scheduled meeting of the board of directors, to announce the discovery (R. 1158–1159). This method of announcing the discovery was chosen "to get the information to the most stockholders as quickly as it was possible," a press conference being "the best media [sic] to get maximum coverage to everyone at the same time" (R. 1161–1162).

Petitioner arrived in New York on April 15 for the directors' meeting (R. 145–146). He went to Texas Gulf's offices and was shown a draft of the press release to be issued the next day and the list of representatives of major newspapers, magazines and news services that had been invited to the press conference (R. 146–147). He believed that the announcement would result in an increase in the market price of Texas Gulf stock (R. 157).

On the morning of April 16 an article about Texas Gulf's discovery appeared in *The Northern Miner,* a weekly Canadian mining journal, which is important in its field but has only a small circulation in the United States (R. 2221–2222; Pet. App. B, 35). The article was based on an interview with Texas Gulf officials three days earlier and described only a 10,000,000-ton ore reserve, as compared to the 25,000,000-ton ore reserve to be announced in Texas Gulf's own press release (R. 908, 915; Pet. App. B, 34–35, 41). The Texas Gulf official who was in charge of relations with *The Northern Miner* did not consider the article to constitute an announcement by Texas Gulf (R. 999). The record does not indicate that any seller of Texas Gulf stock in the United States was aware of this article prior to the time that petitioner placed his order to purchase Texas Gulf stock (R. 2548),[1] and petitioner does not claim that he had any knowledge of the *Northern Miner* article on April 16.

[1] *The Northern Miner* was generally available in Toronto prior to the opening of the market on April 16, and some stock-

The scheduled meeting of the board of directors started at 9:00 a.m. on April 16 with petitioner in attendance (R. 148). After the completion of other business, the president of the corporation either read the press release to the directors or allowed them to read it themselves (R. 199–200). He also indicated that on the previous evening the Ontario Minister of Mines had made a statement about the discovery on radio and television in Canada (R. 89).[2] Petitioner questioned the president of the corporation to make

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brokers there teletyped and telephoned excerpts from the article to their correspondent stockbrokers in New York City (*e.g.*, R. 2187–2190). There is no evidence, however, that a single Texas Gulf stockholder who sold his shares on the morning of April 16 had been informed about the *Northern Miner* article by his stockbroker before his order to sell was executed.

[2] The Ontario Minister had issued no statement on April 15 (R. 164), although Texas Gulf officials had been under the "impression" that he would read a statement they had prepared about the discovery over radio and television from Toronto, Canada, at 11 p.m. that night (R. 1068–1069). The statement prepared for the Minister, however, was "not the same announcement" as Texas Gulf's own press release that it also drafted on April 15 (R. 1110, 1210). It contained no details about the size of the ore body, the tonnage of the ore reserves, the values of the mineralization within the drill cores or Texas Gulf's land rights in the area of the discovery (Pet. App. B, 36, 40–41). Indeed, it did not even state that a "major strike" had been made (Pet. App. B, 36, 40–41). All of these details were included in Texas Gulf's own press release (Pet. App. B, 36, 40–41). The Minister's statement was sent to the press gallery of the Ontario Parliament at 9:40 a.m. on April 16 (R. 4812). There is no evidence in the record that there were

sure that Texas Gulf actually had a major discovery (R. 149).

The board meeting ended shortly before 10:00 a.m., and the representatives of the press were then brought into the directors' room (R. 150). The press release was distributed, the president read it aloud and answered questions and five or six slides of the drill-site were shown (R. 90, 2450–2451). The press conference lasted for 10 or 15 minutes (R. 92). "[E]arly on in the press conference" some reporters began to leave the room (R. 205). Some of the reporters apparently stayed through the end of the press conference and then went into an adjoining office to examine the drill cores (R. 151–152).

Petitioner was unaware which reporter represented any particular news medium and therefore did not know whether the reporter from the Dow Jones Instant News Service left early or stayed through the press conference and then went to examine the drill cores (R. 166–167). The Dow Jones reporter actually left the meeting after the president had read the press release and answered "one or two quick questions" (R. 2451). He called his office and spent about ten minutes dictating a story in two sections (R. 2453). The story appeared on the Dow Jones

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any representatives of the press there at that time, or that the statement was ever reported in the United States or Canada. The president of Texas Gulf, who was aware of the substantial differences between the Minister's statement and Texas Gulf's own release, described the former to the board of directors as being "to the effect that Texas Gulf had discovered north of Timmins what was considered to be a mineable zinc-copper ore body" (R. 1207–1211). He told them nothing more about the content of the statement (R. 1211).

broad tape between 10:54 and 11:02 a.m. in two sections (R. 2455; Pet. App. B, 41).[3]

The record does not indicate the exact time when petitioner left the board room. It was stipulated, however, that at 10:20 a.m. the first of his orders to purchase 2000 shares of Texas Gulf stock for the four family trusts was transmitted to the Midwest Stock Exchange by his son-in-law, a stockbroker in Houston (R. 152, 4794). Before that transmission took place, petitioner had called his law office in Houston, his office had placed another call to put him through to his son-in-law, he had discussed the matter with his son-in-law, his son-in-law had called his firm's floor broker in New York to check the market activity in Texas Gulf stock and only then had the son-in-law entered the orders with the firm's teletype operation in Houston (R. 160–163; J.A. 1680a–1682a).[4] The entire 2000 shares were purchased on the New York and Midwest Stock Exchanges by 10:51 a.m. at prices ranging from 31 to 31⅝ (R. 4794; Pet. App. B, 14). In addition, petitioner's son-in-law divulged the news about the discovery to four of his customers, and they and the son-in-law himself purchased an additional 1500 shares on the exchanges that day (April 16) at prices ranging from 31¼ to 35 (R. 4794; Pet. App.

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[3] The first section would normally have appeared on the broad tape within two or three minutes after the reporter had dictated it. Neither the parties nor Dow Jones has ever been able to discover an explanation for the delay.

[4] "J. A." refers to the Joint Appendix in the court of appeals, a copy of which, along with a copy of petitioner's brief and petition for rehearing in that court (cited on p. 18, *infra*), has been lodged in this Court.

B, 14).[5] The Texas Gulf stock reached a high that day of 37, and by May 15 it was selling at 58¼ (Pet. App. A, 3604).

3. THE DECISION OF THE DISTRICT COURT AS TO PETITIONER

The district court found that petitioner "lost no time in telephoning his son-in-law in order to purchase TGS stock for his family trusts" (Pet. App. B, 42). It also found that, if the officers of Texas Gulf had thought that the "effect [of the rumors, the article in *The Northern Miner* and the assumed statement by the Minister of Mines] was to make the information public there would have been little purpose in making the arrangements for a press conference, and issuing a detailed announcement on April 16" (Pet. App. B, 37). It concluded that the news "did not become public knowledge prior to TGS's official announcement" (Pet. App. B, 37). Finally, the district court found that petitioner "could not * * * assume 'without thinking about it, that the [ore discovery] was already a matter of public information'" when he made the telephone call to his son-in-law (Pet. App. B, 42).

The district court agreed with the Commission that Section 10(b) and Rule 10b–5 prohibit corporate insiders from purchasing their corporation's securities on a national securities exchange when the purchases are made on the basis of material information about the corporation that is unavailable to the sellers (Pet. App. B, 20–24). It also agreed that the Commission

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[5] The son-in-law and his four customers all sold out the next day at a profit (J.A. 1688a).

need not prove scienter or intent to deceive in an enforcement action such as this (Pet. App. B, 18–20). It held, however, that the announcement of the mineral discovery had been made the moment that the press release was given to the reporters, "and it has been the generally accepted rule that it is the making of the announcement that controls" as to when important corporate developments are considered sufficiently public to allow insiders to trade on the basis of the information (Pet. App. B, 42). In the district court's view, that standard could be changed only by a specific regulation of the Commission or by further legislation (Pet. App. B, 43–44). Solely on this basis, it held that petitioner had not violated Section 10(b) and Rule 10b–5 and dismissed the complaint against him, even though it held against another insider who had placed a purchase order on the basis of the same information less than two hours earlier (Pet. App. B, 39–40, 44, 58).[6]

4. THE DECISION OF THE COURT OF APPEALS AS TO PETITIONER

All nine judges of the court of appeals agreed with the district court that Section 10(b) and Rule 10b–5 prohibit corporate officials from trading on the basis of material inside information that has not been disclosed (Pet. App. A, 3605–3607) and that an insider's good faith does not excuse him from his duty of disclosure if he reasonably should have been aware of the

[6] The district court did not reach the question whether Section 10(b) and Rule 10b–5 prohibit the giving of such insider information for trading by others (Pet. App. B, 62 n.13).

duty (Pet. App. A, 3619–3622). Moreover, as to the rumors, the assumed "abbreviated report" by the Minister of Mines and the *Northern Miner* article, they further all agreed that "rumors and casual disclosure through Canadian media, especially in view of the April 12 gloomy or incomplete release denying the rumors and promising official confirmation, hardly sufficed to inform traders on American exchanges * * *" (Pet. App. A, 3622). In addition, they held that the giving of "tips" by insiders is illegal (Pet. App. A, 3615–3616 & n.16).[7]

Contrary to the holding of the district court, the court of appeals unanimously ruled that the reading of the press release to the reporters was "merely the first step in the process of dissemination required for compliance with the regulatory objective of providing all investors with an equal opportunity to make informed investment judgments" (Pet. App. A, 3618). The appellate court also held that "effective protection of the public from insider exploitation of advance notice of material information requires that the time that an insider places an order, rather than the time of its ultimate execution, be determinative for Rule 10b–5 purposes" (Pet. App. A, 3616 n.17). Since the court agreed with the district court that petitioner "could not reasonably have expected the official release to have been disseminated when he placed his order before 10:20 for immediate execution * * *," it concluded that "at the minimum Coates should have

[7] The two dissenting judges did not expressly discuss these questions but necessarily concurred in the majority holdings by joining in the reversal as to petitioner (Pet App. A, 3691).

waited until the news could reasonably have been expected to appear over the media of widest circulation, the Dow Jones broad tape, rather than hastening to insure an advantage to himself and his broker son-in-law" (Pet. App. A, 3618–3619, 3622).[8] The two judges who dissented as to others of the defendants agreed as to petitioner "because for all practical purposes the information had not become public at the time of his purchase order" (Pet. App. A, 3691).

5. THE OTHER DEFENDANTS

The district court held that two other individual defendants had violated Section 10(b) and Rule 10b–5, and that Texas Gulf and nine other individual defendants had not (Pet. App. B, 58). The court of appeals affirmed as to the two individuals who had been found to be violators and as to one who had not, and reversed as to all the other defendants (Pet. App. A, 3639). It remanded the case for further proceedings as to whether Texas Gulf had violated the law and the remedies to be imposed on the violators (Pet. App. A, 3638–3639). These proceedings have not yet taken place.

Although the time for filing petitions for certiorari to review the decision below has run, only one of the

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[8] The court also noted that in some situations the mere appearance of news on the broad tape should not be sufficient to allow insiders to trade and suggested rule-making by the Commission to deal with the problem (Pet. App. A, 3618 n.18). It did not fully discuss this matter, however, because the only defendant whose conduct raised the problem was no longer a party to the appeal (Pet. App. A, 3618 n.18).

other individual defendants has filed a petition (No. 937, this Term). That petition raises basically different questions from this one. Texas Gulf has announced that it intends to petition for certiorari "in due course" (presumably after further proceedings on the remand to the district court and a subsequent decision by the court of appeals). CCH Fed. Sec. L. Rep. ¶ 77,589 (Aug. 15, 1968).

ARGUMENT

All the judges of both courts below, and every other court that has considered the matter, have correctly determined that Section 10(b) and Rule 10b–5 prohibit a corporate insider from trading in the corporation's securities in the market on the basis of important information not available t the public. Indeed, petitioner seems to contest this basic proposition only obliquely. The real issue raised by the petition is only the narrow one whether insiders may trade after announcement of dramatic corporate news but before its publication in any news medium of widespread circulation. The negative answer to this question given by a unanimous *en banc* court below—as to where there is no conflict with any other circuit—does not warrant further review.

1. The protection afforded investors by the prohibition against trading on the basis of material inside information would be seriously undercut if that prohibition were to be lifted at the very moment that dramatic news is handed out to the news media, but before it actually becomes available to the stockholders of the corporation and the investing public in any

meaningful sense.[9] As the court of appeals correctly reasoned, in this type of situation "[b]efore insiders may act upon material information, such information must have been effectively disclosed in a manner sufficient to insure its availability to the investing public" (Pet. App. A, 3617–3618).

The fact that such dramatic news should be published before insiders may trade was recognized long before the enactment of the federal securities laws. For example, Judge Elbert H. Gary, who, as chairman of the board of the United States Steel Company was a leading spokesman for the business community, refused to buy his corporation's stock on the basis of a dividend increase until the day afterwards, so that he would buy "on even terms with the whole world." [10]

Today, with the general use of telecommunications, the Dow Jones broad tape is usually the first widespread publication of important corporate news. Prior to the events of this case it had been considered one

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[9] Petitioner does not contest the holding of both courts below that the "unreliable" rumors, the unmade "abbreviated report" by the Minister of Mines and the article in the *Northern Miner* were legally insufficient for this purpose (see pp. 6–8, 10, 12 *supra*).

[10] A. Cotter, *The Gary I Knew*, 64–67 (1928).

Nor did he have a different attitude with respect to "tips," as appears from the following anecdote:

> If Judge Gary had a son who was in the brokerage business and the Judge knew at three o'clock in the afternoon that an extra dividend would be declared the son would not know it until the newspaper had it the next day.

I. Tarbell, *The Life of Elbert H. Gary, the Story of Steel* 342 (1925).

of the "sanitary precautions" to keep corporate directors away from the telephone until after dramatic corporate news has appeared on the broad tape.[11] Indeed, petitioner testified that declarations of dividends were usually announced by Texas Gulf while directors' meetings were still in progress, and that they would appear on the broad tape before the meeting "had a chance to adjourn" (R. 170).

Petitioner seems to suggest that fairness requires that insiders be permitted to trade at the same time that certain members of the public may do so (Pet. 16–17). His own situation belies this suggestion, as he had generally been aware of the news since the preceding afternoon and received the details half an hour or so before those present at the press conference (see pp. 6–8, 10, *supra*). He thus had an advance opportunity to consider and evaluate it and had a head-start even over those at the press conference. Moreover, in the well known words of then Chief Judge Cardozo, "many forms of conduct permissible in a work-a-day world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place." *Meinhard* v. *Salmon,* 249 N.Y. 458, 464, 164 N.E. 545, 546.[12]

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[11] See Remarks of Mr. Thomas A. Halleran of the New York Bar in Symposium, "Insider Trading in Stocks," 21 Bus. Law. 1009, 1022 (1966).

[12] Contrary to the implications in the petition (Pet. 17), the Commission never argued that the reporters could have called their stockbrokers before their newspapers, or that certain selected brokers were properly present at the press conference.

Petitioner, as a director, of course stood in a fiduciary relationship to the corporation's stockholders.

In view of the unique situation here involved, the holding below that petitioner is liable on the basis of the purchase order he made by telephone does not, contrary to his suggestion (Pet. 17), raise either the question whether some further dissemination than appearance on the Dow Jones broad tape is necessary, or whether a waiting period after dissemination is necessary in order to give the public an opportunity to evaluate the news. The limited scope of the issue means that a decision by this Court would be of limited significance to the other insiders of Texas Gulf or to insiders of other corporations with securities listed on the New York Stock Exchange. Entirely apart from the Act, the Stock Exchange requires insiders of its listed corporations to wait until after the news of "important developments has appeared in the press before making a purchase or sale." New York Stock Exchange, *Company Manual* A–26 (July 18, 1968).

2. Petitioner also claims that he reasonably believed that the news was already available to the public when he telephoned, and that, in any event, the Commission is required to prove that he actually knew that it was unavailable (Pet. 18–21). Both the district court and court of appeals found, however, that he could not have reasonably believed that the news " 'was already a matter of public information' " (see pp. 10, 12–13, *supra*)—a finding that is amply

supported by the evidence (see pp. 6-9, *supra*).[13] Petitioner's legal argument is a reversal of his position in the court of appeals that the Commission's burden would be satisfied if it proved that he "knew *or had reason to know* that his silence would be misleading" (Brief for Appellee Coates, pp. 24, 26, 29) (emphasis added).[14] As held in *Securities and Exchange Commission* v. *Capital Gains Bureau*, 375 U.S. 180, 200, an enforcement proceeding under the analogous anti-fraud provision of another of the federal securities laws,

> to impose upon the Securities and Exchange Commission the burden of showing deliberate dishonesty as a condition precedent to protecting investors through the prophylaxis of disclosure would effectively nullify the protective purposes of the statute.[15]

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[13] The court of appeals did not misunderstand the testimony about Dow Jones' procedures, as petitioner argues (Pet. 20–21 & n.). Although the news could have begun to appear on the broad tape between 10:13 and 10:18 a.m. (Pet. 21), an insider should no more be free to trade after the first sentence of the release appeared than he would if the whole release had been given to him and only the first sentence to the reporters. The complete broad tape report could not have appeared before 10:22 a.m. (see pp. 8–9, *supra*). In any event, although neither court below determined exactly how long before 10:20 a.m. petitioner telephoned his son-in-law, the evidence indicates that it was prior to 10:18 (see pp. 9, 12, *supra*).

[14] In his petition for rehearing before that court (pp. 7–9), however, he urged that, if Rule 10b–5 is so construed, it is unconstitutional.

[15] The Court's earlier comment in a footnote that the failure to disclose in that case was "purposeful," 375 U.S. at 192 n.39, hardly detracts from its broad holding.

The same principle necessarily applies in Commission enforcement actions under Section 10(b) and Rule 10b–5 and has been held to apply under the cognate antifraud provision of the first securities act.[16] Indeed, many federal courts go even further.[17] Petitioner cites no federal decision to the contrary.[18] As the Court of Appeals for the Seventh Circuit held in *Kohler* v. *Kohler Co, supra,* 319 F. 2d 634, 642 (emphasis added), insiders must "scrupulously disclose to outsiders those material facts about a corporation * * * which the insiders *should reasonably believe* are unknown to the outsider."

3. Petitioner also seems to argue, although not explicitly, that Section 10(b) and Rule 10b–5 permit a corporate insider, without appropriate disclosure, to purchase securities in his corporation in an orga-

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[16] *Securities and Exchange Commission* v. *Van Horn*, 371 F. 2d 181 (C.A. 7); Note, 63 Mich. L. Rev. 1070, 1076 (1965).

[17] *E.g.*, *Myzel* v. *Fields*, 386 F. 2d 718, 734–735 (C.A. 8), certiorari denied, 390 U.S. 951; *Stevens* v. *Vowell*, 343 F. 2d 374, 379–380 (C.A. 10); *Royal Air Properties, Inc.* v. *Smith*, 312 F. 2d 210, 212 (C.A. 9), judgment for plaintiffs affirmed, 333 F. 2d 568 (C.A. 9); *United States* v. *Schaefer*, 299 F. 2d 625, 629 (C.A. 7), certiorari denied, 370 U.S. 917; *Ellis* v. *Carter*, 291 F. 2d 270, 274 (C.A. 9), dismissal affirmed, 328 F. 2d 573 (C.A. 9); *Texas Continental Life Ins. Co.* v. *Bankers Bond Co.*, 187 F. Supp. 14, 22–23 (W.D. Ky.), reversed on other grounds sub nom. *Texas Continental Life Ins. Co.* v. *Dunne*, 307 F. 2d 242 (C.A. 6).

[18] There is no inconsistency between the decision below as to petitioner and the court's quotation from the Commission's decision in *Cady, Roberts & Co.*, 40 S.E.C. 907, 912, as petitioner argues (Pet. 18). That case involved a broker who clearly knew that the news was unavailable, and the Commission limited its language accordingly. But that is no reason to conclude that proof of actual knowledge is necessary.

nized securities market on the basis of information that he knows to be material and not available to the public (Pet. 11–16).[19] He bases this conclusion on the premise that an insider has no duty to disclose material inside information when trading on an exchange (Pet. 14–16), and that such conduct is therefore not fraudulent or deceptive. But such a duty clearly exists.

The Congress that passed the Act firmly held the view that corporate officials owe fiduciary duties directly to the stockholders and not merely to the fictional corporate entity. S. Rep. No. 1455, 73d Cong., 2d Sess. (1934), pp. 55, 67–68.[20] "Among the most vicious practices unearthed * * * [in the legislative hearings] was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid

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[19] Petitioner was held to have violated Section 10(b) and Rule 10b–5 not only by his own purchases but also by his having given a tip to his son-in-law (see pp. 9–10, 12, *supra*). He does not contend that such a tip would be lawful if given with knowledge that the information was not available to the public. See *Ferraioli* v. *Cantor*, 281 F. Supp. 354 (S.D. N.Y.); *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, CCH Fed. Sec. L. Rep. ¶ 77,629 (S.E.C.); cf. *Kuehnert* v. *Texstar Corp.*, 286 F. Supp. 340 (S.D. Tex.); *Ross* v. *Licht*, 263 F. Supp. 395 (S.D. N.Y.); *Blyth & Co.*, CCH Fed. Sec. L. Rep. ¶ 77,647 (S.E.C.); *Herbert L. Honohan*, 13 S.E.C. 754, 757–758, modified in other respects, 16 S.E.C. 297; 3 L. Loss, *Securities Regulation* 1450–1451 (2d ed. 1961). See also, *Mosser* v. *Darrow*, 341 U.S. 267, 271–272.

[20] Accord, H. Rep. No. 1383, 73d Cong., 2d Sess. (1934), pp. 5–6, 11, 13; 78 Cong. Rec. 7861–7862, 8037, 8038 (1934).

them in their market activities." *Id.* at 55.[21] Indeed, some 60 years ago, long before the passage of the Act, this Court held that, when he is making such purchases, a corporate insider is under a duty to disclose when "special facts" exist. *Strong* v. *Repide,* 213 U.S. 419, 431. Since the passage of the Act, the federal courts have uniformly held that Section 10(b) and Rule 10b–5 require insiders to disclose material inside information to those from whom they purchase their corporation's securities.[22]

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[21] This language is contained in the section of the report dealing with "Market Activities of Directors, Officers, and Principal Stockholders of Corporations." Section 16(b) of the Act, 15 U.S.C. 78p(b), provides for the recovery by the corporation of profits from short-swing transactions by such persons. Although petitioner does not claim that Section 16(b) of the Act preempts the insider trading field, he does purport to find some support in it (Pet. 13–14). The district court in this case spelled out at length the differences between Section 10(b) and Section 16(b) and the reasons why the provisions of the latter impose no limitation on the former (Pet. App. B, 20–21). Moreover, as this Court has already held under another of the securities laws, a provision comparable to Section 16(b) does not impose additional restrictions on other provisions of the statute, since it "cannot be regarded as a limitation upon the power of the Commission to deal with other situations in which officers and directors have failed to measure up to the standards of conduct imposed upon them * * *." *Securities and Exchange Commission* v. *Chenery Corp.*, 318 U.S. 80, 91. Cf. *Securities and Exchange Commission* v. *National Securities, Inc.*, No. 41, this Term, decided January 27, 1969, slip op., p. 15.

[22] *Myzel* v. *Fields, supra; List* v. *Fashion Park Inc.*, 340 F. 2d 457 (C.A. 2), certiorari denied, 382 U.S. 811; *Kohler* v. *Kohler Co., supra; Reed* v. *Riddle Airlines*, 266 F. 2d 314 (C.A. 5); *Cochran* v. *Channing Corp.*, 211 F. Supp. 239, 242–243 (S.D. N.Y.); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del.), final judgment awarded, 135 F. Supp. 176 (D. Del.), affirmed as modified, 235 F. 2d 369 (C.A. 3); *Kardon* v. *National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa.), modified in other respects,

As the courts below recognized, this duty to disclose, whether it be stated in terms of special facts or undisclosed material facts, should not be limited to face-to-face transactions. Such a limitation, as the court below had previously pointed out, "would be contrary to the intent of Congress, as set forth in section 2 of the Securities Exchange Act, 15 U.S.C. § 78b, which was to regulate 'transactions in securities as commonly conducted upon securities exchanges [as well as] over-the-counter markets.'" *List* v. *Fashion Park, Inc., supra,* 340 F. 2d at 462.[23]

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83 F. Supp. 613 (E.D. Pa.); *Mansfield Hardwood Lumber Co.* v. *Johnson*, 268 F. 2d 317, 319 n.3 (C.A. 5) (dictum), certiorari denied, 361 U.S. 885.

Petitioner claims that the cases under the Act turn, like *Strong*, on the existence of "special facts," and that the materiality of the undisclosed information cannot itself be regarded as a special fact giving rise to a duty to disclose it (Pet. 15–16). But the commentators uniformly consider the special facts in *Strong* to have been the importance of the corporate development and the insider's role in it, and the courts have frequently found liability under the special facts doctrine on this basis. R. Baker & W. Cary, *Cases and Materials on Corporations* 559–560 (3d ed. unabr. 1959); 3 W. Fletcher, *Private Corporations* § 1171 (perm. ed. rev. rep. 1965); 3 L. Loss, *supra*, at 1447–1448; R. Stevens, *Corporations* 582–583 (1936).

[23] The *List* opinion also answered petitioner's contention that purchases of stock on a national securities exchange on the basis of material inside information do not induce other investors to sell their stock at that time (Pet. 11–13, 16), pointing out that the concept of reliance is not limited to a situation in which the investor

> actively relied on the silence of the defendant, either because he consciously had in mind the negative of the fact concealed, or perhaps because he deliberately put his trust in the advice of the defendant. * * * The proper test is whether the plaintiff would have been influenced to act

Indeed, disclosure is more important in impersonal transactions because the stockholder who deals with an insider on a face-to-face basis has an opportunity to make informal inquiry whether the insider is in possession of any material information not available to the public.[24] "Dishonest directors should not find absolution from retributive justice by concealing their identity from their victims under the mask of the stock exchange." H. Ballantine, *Corporations* 216 (rev. ed. 1946).

4. Relying on the Fifth Amendment, petitioner also complains that Rule 10b–5 is not sufficiently definite to have given him notice that his conduct was proscribed (Pet. 21–25).

In this area "[t]he test is whether the language conveys sufficiently definite warning as to the proscribed conduct when measured by common understanding and practices." *Jordan* v. *DeGeorge,* 341 U.S. 223, 231–232; accord, *Sproles* v. *Binford,* 286 U.S. 374, 393; *McGowan* v. *Maryland,* 366 U.S. 420, 428; *United States* v. *National Dairy Prods.,* 372 U.S. 29, 32. See, also, *Securities and Exchange Commission* v. *Capital Gains Bureau, supra.*

There are, of course, some areas of the law in which it is not possible to anticipate all kinds of harmful

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differently than he did act if the defendant had disclosed to him the undisclosed fact.

340 F. 2d at 463. *Accord, Myzel* v. *Fields, supra,* 386 F. 2d at 735. If insiders are under a duty to disclose material inside information when relying on that information in purchasing securities on a stock exchange, their conduct necessarily deceives other investors in the market if they do not fulfill that duty.

[24] Cf. *Broffe* v. *Horton,* 172 F. 2d 489, 494 (C.A. 2).

conduct by specific rules. Prohibitions of fraud and deception fall within this category. Rule 10b–5 is, therefore, necessarily stated in rather broad terms which absorb their meaning from the particular business context in which the deceptive practices occur. Cf. *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 202–203.[25]

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[25] The court of appeals has suggested that the Commission use its rulemaking power to achieve clarification of the timing problem—at least with respect to a waiting period after publication (see n. 8, *supra*). Such a waiting period is no longer an issue in this case. Nevertheless, although the Commission's initial judgment was that a specific rule on this subject would be undesirable, it will re-evaluate that position in light of the views of the court below. But the fact that the Commission may yet be able to devise such a rule based upon its experience with this case does not mean that it was required to have anticipated petitioner's situation by a more specific rule. *See* remarks of Judge Friendly in "Conference on Codification of the Federal Securities Laws," 22 Bus. Law 793, 900, 901 (1967).

CONCLUSION

Despite the significance of the case out of which this petition for a writ of certiorari arises, the petition itself does not present any questions warranting review by the Court and should be denied.

Respectfully submitted.

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